

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

ILLINOIS INDEPENDENT TELEPHONE)	
ASSOCIATION)	
)	00-0233
Petition for initiation of an investigation)	
of the necessity of and the establishment)	
of a Universal Service Support Fund)	
in accordance with Section 13-301(d))	
of the Public Utilities Act)	
)	
ILLINOIS COMMERCE COMMISSION)	
ON ITS OWN MOTION)	
)	00-0335
Investigation into the necessity of and,)	
if appropriate, the establishment of a)	
universal support fund pursuant to)	
Section 13-301(d) of the Public Utilities Act.)	

**TESTIMONY OF
CATE HEGSTROM
ON BEHALF OF
AT&T COMMUNICATIONS OF ILLINOIS, INC.**

AT&T Exhibit 3.0

May 11, 2001

1 **Q. Please state your name and business address.**

2 A. My name is Cate Hegstrom. My business address is 222 West Adams St., Suite
3 1500, Chicago, IL 60606.

4
5 **Q. By whom are you employed and in what capacity?**

6 A. I am employed by AT&T as a District Manager - Government Affairs.
7

8 **Q. Describe your education and professional background.**

9 A. I received a B.A. degree in Mathematics from Benedictine College in Atchison,
10 Kansas. In December 1974, I began my telecommunications career in the
11 Network Operations Department of AT&T Long Lines in Omaha, Nebraska. My
12 responsibilities included the provisioning and maintenance of the switched and
13 special services network. In 1977, I joined the Regulatory Department of
14 Northwestern Bell Telephone Company (NWB), where I performed cost and rate
15 studies used in connection with private line, ENFIA and related services. In 1983,
16 I returned to AT&T, joining what became the Marketing Plans Implementation
17 organization of AT&T Communications in Omaha. In that position, I was
18 primarily responsible for analyzing Local Exchange Carrier ("LEC") access
19 filings within the five NWB states.

20
21 In 1986, I accepted a position with the AT&T Communications staff organization
22 in New Jersey. My duties included the analysis of regulatory issues and the
23 development of positions related to AT&T's intrastate services.

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In 1988, I joined AT&T Corp.’s External Affairs organization in Chicago, where my job duties included contracting and liaison activities between AT&T and several large independent telephone companies in AT&T's ten Central Region states. In 1990, I assumed responsibility for the analysis and administration of access-related issues and LEC regulatory issues affecting AT&T’s intrastate operations in several Central Region states, including Illinois. In January 1997, I accepted the position of District Manager-Regulatory Matters.

- Q. Have you previously filed testimony before the Illinois Commerce Commission (“ICC”) or (the “Commission”)?**
- A.** Yes. I have testified before the Commission in ICC Docket No. 93-0044 (MCI and LDDS Complaint against Illinois Bell), ICC Docket No. 93-0409 (MFS Application for an Amended Certificate), ICC Docket Nos. 93-0301/94-0041 (GTE North Rate Case), ICC Docket Nos. 94-0042 through 94-0046 (Investigation of Switched Access Local Transport Restructure Rates), ICC Docket Nos. 94-0048, 94-0049, 94-0117 and 94-0146 (Rulemakings for Presubscription and Line Side Interconnection, Ameritech Customers First Plan, AT&T Petition), ICC Docket No. 94-0480 (Investigation into Physical Collocation), ICC Docket Nos. 95-0458/95-0531 (Petition for Wholesale Service Tariffs of Ameritech and Centel Companies), ICC Docket Nos. 95-0135/ 95-0179 (Illinois Bell Reclassification of Bands B and C Usage/Increase to Business Band C Rates), ICC Docket No. 96-AB-005 (AT&T/GTE North Arbitration), ICC Docket No. 97-0621 (DEM Stipulation), Phases I and II of ICC Docket Nos. 97-

1 0516/97-0601/97-0602, ICC Docket No. 98-0321 (Gallatin River Acquisition
2 Application), ICC Docket No. 98-0866 (Bell Atlantic/GTE Merger), ICC Docket
3 No. 99-0038/99-0039 (Ameritech Access Refund Complaint), ICC Docket No.
4 98-0860 (Competitive Classification of Ameritech Services), Phase I of ICC
5 Docket Nos. 00-0233/00-0335 (PUA Section 13-301(d) USF Investigation) and
6 ICC Docket Nos. 98-0252/98-0335/00-0764 (Ameritech Alternative Regulation
7 Review/Rate Rebalancing). I have also represented AT&T in a number of Illinois
8 workshop proceedings including those convened in ICC Docket No. 90-0425
9 (Access Charges), ICC Docket No. 92-0210 (Imputation Rulemaking), ICC
10 Docket No. 92-0211 (Cost of Service Methodology and Rulemaking), ICC
11 Docket No. 92-0398 (Interconnection Rulemaking) and ICC Docket No. 00-0555
12 (ISP Reciprocal Compensation).

13
14 **Q. Have you testified before other state commissions?**

15 A. Yes. I testified before the Michigan Public Services Commission in Case No. U-
16 10647 (City Signal Complaint), Case No. U-10860 (Generic Interconnection
17 Investigation), Case No. U-11053 (ACI Application), Case Nos. U-11151/U-
18 11152 (Ameritech Arbitration), Case No. U-11165 (GTE North Arbitration), Case
19 No. U-11660 (AT&T Complaint Against Ameritech Access PIRCC Rates), Case
20 No. U-11831 (Ameritech Michigan TSLRIC review), Case No. U-11832 (GTE
21 North TSLRIC review), Case No. U-11899 (USF Investigation), Case No. U-
22 12287 (AT&T Complaint Against Ameritech Access Rates), Case No. U-12465
23 (Ameritech Arbitration) and Case No. U-12528 (Local Calling Scope

Investigation). I have testified before the Indiana Regulatory Utility Commission in Cause No. 39369 (Access Investigation), Cause No. 39385 (Special Access CSOs), Cause No. 40571-INT-02 (GTE North Arbitration), Cause No. 40785 (Universal Service and Access Charge Restructure Investigation), Cause No. 41255 (Ameritech/SBC Merger Application), Cause Nos. 40785-S1/40849/41058 (Ameritech Opportunity Indiana/Trilogy Compliance Investigation) and Cause No. 40571-INT-03 (Ameritech Arbitration). I also testified before the Public Utilities Commission of Ohio in Case Nos. 92-1525-TP-CSS/92-1149-TP-ALT (Western Reserve Alternative Regulation), Case No. 96-832-TP-ARB (GTE North Arbitration), Case No. 96-336-TP-CSS (Ameritech Access Service Rate Complaint), Case No. 98-1398-TP-AMT (Bell Atlantic/GTE Merger), Case No. 00-1188-TP-ARB (Ameritech Arbitration) and before the Public Service Commission of Wisconsin in Docket Nos. 265-MA-102/2180-MA-100 (GTE Arbitration), Docket No. 6050-TI-101 (Frontier Alt. Reg.), Docket No. 05-TI-174 (Price Regulation Review), Docket Nos. 6720-TI-156/6720-TI-157 (PICC Complaint against Ameritech Wisconsin), Docket Nos. 1910-T1-101/2050-T1-100/3070-T1-100/6040-T1-100/5530-T1-100/4590-T1-100 (CenturyTel Company (6) Alternative Regulation Applications), Docket Nos. 2055-NC-100; 2055-TR-100, et al. (CenturyTel Purchase of GTE Exchanges), Docket No. 2815-TR-103 (CenturyTel-Kendall Petition for Rate Increases) and Docket No. 05-MA-120 (Ameritech Arbitration).

Q. What is the purpose of the your direct testimony?

1 A. The purpose of my testimony is to respond to the direct testimony of Mr.
2 Schoonmaker, specifically regarding the methodology he recommends the
3 Commission adopt in determining a need for a state universal service fund and
4 eligibility for receipt of fund support. Additionally, I will provide AT&T's
5 recommendation to the Commission for a competitively neutral funding
6 mechanism for the fund that is the subject of the second phase of these
7 consolidated dockets.

8
9 Dr. Richard Clarke is also providing direct testimony, specifically addressing the
10 appropriateness of Mr. Schoonmaker's modifications to the HAI Model input
11 values.

12

13 **Q. Mr. Schoonmaker suggests the Commission adopt the FCC's current list of**
14 **supported services as the services that would be eligible for support from a**
15 **state universal service fund. (Direct, pp. 10-11) Do you agree?**

16

17 A. I agree with Mr. Schoonmaker's recommendation that the Commission adopt the
18 same definition of supported services as the FCC has adopted. However, I would
19 note that the FCC's definition does not specify that services are to necessarily be
20 applied to all access lines or to some subset of access lines. Stated another way,
21 although the FCC defined universal service, in part, as "voice grade access to the
22 public switched network" and "single-party service or its functional equivalence",
23 the definition does not specify a customer class. The criteria upon which the FCC
24 relied in its determination included four components, two of which are key in
25 discussing this issue: 1) essential to education, public health, or public safety, and

1 2) have, through the operation of market choices by customers, been subscribed to
2 by a substantial majority of residential customers. (TA96, Section 254(c)) That
3 being said, currently the FCC has allowed all access lines of the rural ILECs to be
4 eligible for support. The statute, however, requires the group of services to be
5 declared supported services to, “at a minimum, include those services as defined
6 by the Federal Communications Commission”. (PUA Section 13-301(e)(1))
7 Therefore, I believe the Commission has the option of applying the *definition* of
8 universal service to all access lines or to some subset of access lines.

9

10 **Q. To what subset of lines could the Commission apply its definition of universal**
11 **service lines?**

12

13 A. There are four readily discernable subsets of access lines that I raise for
14 consideration by the Commission:

15 a) Primary Residential Access Lines;

16 b) All Residential Access Lines;

17 c) Primary Residential and Single Line Business Access Lines; and

18 d) All Residential and Single Line Business Access Lines.

19

20

21 **Q. Which set or subset of access lines do you recommend the Commission**
22 **adopt?**

23

24 A. If the Commission determines that a state universal service fund is needed and is
25 in the public interest, companies that are competitors or potential competitors of
26 fund recipients will be required to provide such funding. It is critical then that
27 support for any access lines be based on forward-looking costs. Therefore, if the

1 Commission determines that costs submitted in these proceedings meet that
2 criteria, I do not oppose the application of the definition of universal service being
3 extended to all access lines, and, therefore, potentially making all access lines
4 available for state fund support.

5

6 **Q. Do you agree that the method of calculating the potential size of a state fund**
7 **as proposed by Mr. Schoonmaker complies with the requirements of Section**
8 **13-301(d) of the Illinois Public Utilities Act?**

9

10 A. Not entirely. Mr. Schoonmaker approaches the use of this fund much like a
11 revenue pool. As an example, in sizing the fund, as demonstrated in the last
12 column of IITA Exhibit #2, Attachment 5, Mr. Schoonmaker “nets out” excess
13 revenues of companies which receive rates and federal support in excess of
14 economic costs. If the Commission were to adopt Mr. Schoonmaker’s proposed
15 method of calculations, it would result in restricting the support of another
16 company. There is no provision in Section 13-301(d) to support such a
17 methodology.

18

19 The universal service fund under investigation in these proceedings is defined
20 specifically to provide support to companies whose economic costs exceed
21 revenues generated via Commission approved affordable rates for services
22 defined as universal services. The demonstration of need must be company
23 specific. That is, Section 13-301(d) only allows for the use of a *cost* proxy (rather
24 than requiring a company specific economic cost), but does not allow for a
25 revenue proxy. In short, the Commission simply does not have the discretion to

1 order funds to be distributed on any basis that is not consistent with the
2 requirements of Section 13-301(d).

3

4 In my testimony, I discuss for the Commission the reasons why Mr.
5 Schoonmaker's proposed calculation methods are not consistent with the
6 requirements of Section 13-301(d), and provide an alternative method that does
7 meet the requirements of the Public Utilities Act.

8

9 **Q. The results of Mr. Schoonmaker's HAI cost study calculations, using**
10 **modified input values, results in an average line cost of \$91.74. Do you agree**
11 **the average line cost is an appropriate figure to use as a proxy cost in these**
12 **proceedings?**

13

14 **A.** Yes. As Dr. Clarke discusses, Mr. Schoonmaker assumes a "pick and choose"
15 method of applying costs at a company level or at an aggregated level. Dr. Clarke
16 discusses why use of the average costs is most appropriate in his testimony.
17 However, as discussed by Dr. Clarke, and demonstrated by Mr. Schoonmaker,
18 there is a broad range of costs that can be derived by varying some (or none) of
19 the input values. As an example, Mr. Schoonmaker provides his recommendation
20 for the Commission to adopt an average line cost of \$91.74. In IITA response to
21 discovery, Mr. Schoonmaker has demonstrated that, if all HAI 5.0a inputs are
22 maintained at their default values, the average line cost that results is \$60.42. Dr.
23 Clarke discusses in his direct testimony which modified or alternative input
24 values produces a more realistic economic cost figure. Irrespective of the input
25 values and resulting costs, I agree that the average costs of all companies involved

1 should be used as the proxy costs for all companies for purposes of satisfying
2 Section 13-301(d) requirements.

3

4 **Q. In his direct testimony, Mr. Schoonmaker turns to the issue of what**
5 **affordable rate should be used in satisfying the requirements of Section 13-**
6 **301(d). Do you agree with his recommendation to use the current rates that**
7 **are in effect as the minimum level of an “affordable rate”?**

8

9 A. Somewhat. While I agree that the Commission can adopt a company’s rates as
10 the affordable rates, I do not agree that the Commission should adopt a company’s
11 *current* rates as the affordable rate. Based on IITA response to discovery, I have
12 verified that some rural LECs have decreased local rates during the past ten years.
13 As an example, in 1995 Harrisonville Telephone Company eliminated its charges
14 for Touch Tone service without providing a concurrent and equivalent increase in
15 its local rates. The affordable rate for this company’s exchanges should include
16 the past touch tone rate. I would recommend that the minimum affordable rate for
17 services defined as universal services be the highest level in effect during the last
18 decade for each individual company.

19

20 It is my understanding that Staff and other parties may be offering
21 recommendations of methodologies by which the Commission may make a more
22 informed decision as to an affordable rate for these companies. I will respond to
23 such proposals as necessary in my rebuttal testimony.

24

25 **Q. Do you agree with the various service rates that Mr. Schoonmaker has**
26 **included in his calculation of an affordable rate?**

27

1 A. Yes. I would note that Mr. Schoonmaker does not include the federal End User
2 Line Charge (“EUCL”) rates in his calculation of the affordable rate. He does,
3 however, include the federal EUCL revenues in offsetting federal support later in
4 his calculations. (IITA Exhibit 2.0, p. 44.) It is more appropriate to include the
5 federal EUCL in the affordable rate. While such a modification does not change
6 the eligibility status of a company, it could have an impact in determining what
7 local service rate level the Commission eventually determines is “affordable”. If
8 the Commission restricts application of the definition of universal service to a
9 subset of access lines, as I discussed above, it may be necessary to modify the
10 inclusion of these federal EUCL revenues.

11

12 **Q. Why do you suggest that it *may* be necessary to modify the inclusion of**
13 **federal EUCL revenues?**

14

15 A. Currently, federal EUCL charges vary by class of end user customer. The federal
16 EUCL for residential lines and single-business lines is \$3.50, and the multi-line
17 business EUCL is \$6.00. If, for example, the Commission were to restrict the
18 application of the definition of universal service to residential lines, it could
19 include the federal residential EUCL charge in its calculation of an affordable
20 rate. However, it is also appropriate for the Commission to include all other
21 customer class EUCL revenues (i.e., business EUCL revenues) as federal revenue
22 offsets to any state funding needs, as these revenues contribute toward a
23 company’s total separated costs of loops.

24

1 **Q. In Revised IITA Exhibit #2, Attachment 5, Mr. Schoonmaker provides a**
2 **demonstration that each rural company's economic costs exceed the**
3 **affordable rate for the respective company. Do you have comments on this**
4 **demonstration?**

5
6 A. Yes. I agree with Mr. Schoonmaker in the need to compare each company's
7 affordable rate with the proxy cost, i.e., the average HAI line *costs*. However, it
8 is not appropriate for purposes of satisfying Section 13-301(d) requirements to
9 compare the proxy cost to the average *affordable rate*. The statute does not allow
10 for a proxy affordable rate for each company. Indeed, to the extent that Mr.
11 Schoonmaker himself recommends the Commission adopt each company's
12 current rates as the affordable rate, a calculation of an average affordable rate
13 serves no purpose in satisfying the statutory requirements. Therefore, I have
14 modified Mr. Schoonmaker's table accordingly. This modification is included in
15 AT&T Exhibit 3.1.

16
17 Additionally, if the Commission adopts costs based on input values different from
18 those utilized by Mr. Schoonmaker, as discussed above, the calculation would
19 obviously need to be revised. I have prepared such a revision, basing costs on the
20 HAI 5.0a default input values. This revision is contained in Column #4 of Exhibit
21 3.2 of my testimony.

22
23 **Q. Mr. Schoonmaker next provides a calculation offsetting any revenue shortfall**
24 **by federal funds support. Have you provided the same offsets in your**
25 **revised calculations?**

26
27 A. Yes. Column #6 of AT&T Exhibits 3.1 and 3.2 provides this calculation. Using
28 Mr. Schoonmaker's proxy cost value of \$91.74 results in a potential fund sized at

1 \$73,479,482. Using the proxy cost of \$60.42 results in a potential fund sized at
2 \$29,929,721.

3

4 **Q. Are these figures representative of a state fund that would satisfy the**
5 **requirements of Section 13-301(d)?**

6

7 A. No. As Mr. Schoonmaker correctly notes, the statute also contains a requirement
8 that implicit subsidies be identified. Mr. Schoonmaker attempts to identify
9 implicit subsidies in Attachment #6 of his direct testimony. However, Mr.
10 Schoonmaker determines whether an implicit subsidy is contained in each
11 company's intrastate access rates by again comparing them to company-specific
12 HAI costs. Just as I (and Mr. Schoonmaker) recommend that the *average* line
13 cost be used as a proxy for purposes of satisfying the requirements of Section 13-
14 301(d), so too should the *average* HAI access cost of \$0.07618 be used to
15 determine whether each individual company's access rates contain an implicit
16 subsidy. I have provided such a comparison in AT&T Exhibit 3.3, using Mr.
17 Schoonmaker's calculated HAI costs. At the time of preparing this testimony, I
18 had neglected to request the value of HAI access costs based on the use of the
19 default input values. It is my intention to provide a similar demonstration of
20 potential subsidy in my rebuttal testimony.

21

22 **Q. In what way do you recommend this statutorily-required demonstration be**
23 **utilized in the Commission's determination of sizing a state universal service**
24 **fund?**

25

26 A. The statute provides that the Commission shall "identify all implicit subsidies
27 contained in rates or charges of incumbent local exchange carriers, including all

1 subsidies in interexchange access charges, and determine how such subsidies can
2 be made explicit by the creation of the fund.” PUA Section 13-301(e)(2) Given
3 the fact that the access costs provided are proxy costs rather than company
4 specific economic costs, it is impossible to determine the actual level of implicit
5 subsidies that might currently be contained in any given rural company’s access
6 service rates. Indeed, Mr. Schoonmaker concurs with this, although he concludes
7 that until a stand alone cost study is performed, a determination that any implicit
8 subsidies exist cannot be made. I do not agree that a stand alone cost study is
9 needed to determine whether a subsidy is contained in a service rate. Regardless,
10 at this time I recommend that if this demonstration results in an indication that
11 some level of implicit subsidies exists for any given company, that company
12 should be ineligible for any state universal service funding.

13

14 **Q. At this time, which companies would not be eligible for any state universal**
15 **service funds using Mr. Schoonmaker’s average costs and your**
16 **methodology?**

17

18 A. Obviously, the eligibility will be based on the initial determination as to whether
19 a company’s universal services revenues are less than the associated costs adopted
20 in these proceedings by the Commission. If one uses the proxy costs as
21 recommended by Mr. Schoonmaker, and my methodology of calculations, the
22 following companies would not be eligible for receipt of any Section 13-301(d)
23 funds at this time:

24 Kinsman
25 Leaf River
26 Leonore
27 Madison

1 Moultrie
2 Stelle
3

4 Removal of these companies' potential fund distributions reduces the size of the
5 fund to \$71,155,007. With my rebuttal testimony, I will provide a similar list of
6 ineligible companies resulting from use of proxy costs based on HAI 5.0a default
7 input values.
8

9 The actual list of companies eligible to receive fund support can only be
10 determined using the proxy costs, the affordable rates, and the implementation of
11 implicit subsidy indications eventually adopted by the Commission in these
12 proceedings. Additionally, on May 31st parties are scheduled to respond to the
13 rate-of-return analysis offered in testimony prefiled on April 20th by Mr.
14 Schoonmaker and the local exchange companies referenced in Section 13-301(d).
15 This presumably will provide the final factor in the determination of a company's
16 eligibility for state fund support.
17

18 **Q. Mr. Schoonmaker recommends that this docket be reopened or a further**
19 **proceeding should be held to evaluate future Illinois universal service**
20 **funding needs if industry policy changes at either the state or federal level**
21 **cause changes in the companies' revenue streams. Do you agree?**
22

23 **A.** Mr. Schoonmaker refers to investigations initiated by the FCC that could impact
24 interstate access rates, and, as a result of the Commission's current mirroring
25 policy, could impact the intrastate access rates of the rural ILECs. I do agree that
26 there may be an impact on LEC revenue streams as a result of FCC activity. To

1 the extent that such an impact is significant enough to negatively affect a rural
2 incumbent LEC's earnings, it is certainly plausible that the Commission may want
3 to investigate whether universal service in Illinois is also impacted. However, the
4 Commission should note that the FCC has already determined that rural LEC per
5 minute-of-use access economic costs are estimated to be at a level no greater than
6 \$0.0095. *See* CC Docket No. 96-262, CALLS Order rel. May 31, 2000, ¶177.
7 Additionally, the proposal offered to the FCC by the Multi-Association Group
8 ("MAG") provides for a traffic-sensitive target rate of \$0.016 per minute-of-use.
9 *See* CC Docket No. 00-256, NPRM rel. January 5, 2001. I am not aware of any
10 proposal before the FCC that provides for access reductions below these levels.
11 Having said that, the Commission should be motivated only by universal service
12 concerns, and not simply by a negative impact to a company's revenue streams.
13 Absent a universal service concern, it would be the responsibility of an individual
14 LEC to petition for an investigation (such as filing a general rate case) if it
15 believes its revenue requirement/earnings need to be reexamined.

16

17 **Q. Are there other issues the Commission should address in these proceedings?**

18

19 A. Yes. Section 13-301(d) also requires that if a universal service support fund is
20 established, "the Commission shall require that all costs of the fund be recovered
21 from all local exchange and interexchange telecommunications carriers
22 certificated in Illinois on a competitively neutral and nondiscriminatory basis."

23

24 **Q. What is AT&T's recommendation for a competitively neutral funding**
25 **mechanism that should be adopted by the Commission?**

1
2 A. As I had stated in my rebuttal testimony in the initial phase of these proceedings,
3 AT&T continues to assert that the superior method is one in which fund
4 assessments for the carriers be based upon the carriers' intrastate retail revenues
5 net of carrier-to-carrier payments. However, as I had proposed in my direct
6 testimony in the initial phase of these proceedings, use of intrastate regulated
7 retail revenues as a basis is a competitively neutral mechanism that is also
8 acceptable to AT&T.
9

10 **Q. Why did you change your recommendation in Phase I of these consolidated**
11 **proceedings for the method of assessment?**
12

13 A. I had advocated the use of intrastate retail revenues as the basis for a funding
14 methodology as this would be consistent with the funding methodology adopted
15 by the FCC for the federal universal service fund, and therefore consistent with
16 the requirements of the federal Telecommunications Act ("TA96"). In my
17 rebuttal testimony during the first phase of this proceeding, I supported the
18 intrastate regulated revenues net of payments to carriers as being a superior
19 funding method, based on the fact that this assessment would be based on each
20 carrier's total intrastate revenues. In my proposal (i.e., intrastate *retail* revenues),
21 the revenues associated with carrier-to-carrier payments would actually be
22 counted as the revenues of the carrier that owns theses payments as expenses (i.e.,
23 the IXC), rather than the carrier that owns these payments as revenues (i.e., the
24 LEC).
25

1 In addition to the reasons given in my rebuttal testimony in the initial phase of
2 these proceedings, I would also note that the FCC has recently issued an NPRM
3 to test the concept of a unified regime for the flows of payments among
4 telecommunications carriers that result from the interconnection of
5 telecommunications networks under current systems of regulation. CC Docket
6 No. 01-92, NPRM rel. April 27, 2001, ¶1. Specifically, the FCC is examining the
7 concept of Central Office Bill & Keep (“COBAK”), in which no carrier would
8 recover any costs of its customers’ local access facilities from an interconnecting
9 carrier, but rather, a calling party’s network would be responsible for the cost of
10 transporting the call to the called party’s central office. Id., ¶23. If and when the
11 FCC adopts inter-carrier compensation rules based on this concept, corresponding
12 state revenues would more closely resemble today’s retail revenues net of carrier
13 payments. Therefore, in order to more closely align funding obligations with a
14 company’s assets, etc., and in order to avoid swings in the proportional
15 obligations in the future, the Commission should adopt the method of assessment
16 based on a carrier’s intrastate revenues net - payments to carriers.

17
18 **Q. Would adopting intrastate retail revenues as the basis of fund assessment**
19 **satisfy Section 13-301(d)’s competitively neutral and nondiscrimination**
20 **requirement?**

21
22 **A.** Yes. By way of demonstration, the courts have already ruled that an equivalent
23 methodology adopted by the FCC satisfies the corresponding requirements of the
24 federal TA96. See, e.g., CC Docket No. 96-45, Sixteenth Order on
25 Reconsideration, rel. October 8, 1999, ¶¶4 & 10. Furthermore, the FCC has

1 indicated that it would not extend its COBAK concept to interstate access services
2 for several years. Id., ¶97. If the Commission does not choose to adopt the
3 method of fund assessment that is most closely aligned with that concept, i.e.,
4 intrastate revenues net carrier payments, it should adopt intrastate retail revenues
5 as the basis for fund assessments in compliance with the requirements of Section
6 13-301(d).

7

8 **Q. In the initial phase of these proceedings, the issue of using a competitively**
9 **neutral funding mechanism as the basis for the limited true-up provided for**
10 **in the order providing for the current DEM Weighting Fund assessment was**
11 **also addressed. Do you recommend this method with the understanding that**
12 **it would also be utilized for the purposes of a true-up to the 1998, 1999, 2000**
13 **and 2001 DEM Weighting Funding?**

14

15 A. Yes. In the Stipulated Agreements adopted by the Commission in Docket Nos.
16 97-0621 and 98-0679, the parties agreed to a limited true-up of contributions to
17 the DEM Weighting Fund based upon an eventual determination of a
18 competitively neutral funding mechanism by the Commission. Per the Order
19 adopting the initial Stipulated Agreement, “[t]hose parties will have the
20 opportunity to propose intrastate universal service funding methodologies, which
21 they believe to be consistent with the federal Act and relevant FCC Orders.”
22 (ICC Docket 97-0621, Order approved July 8, 1998, page 8, emphasis added.)

23

24 **Q. What requirements are included in TA96 concerning the funding of a**
25 **universal service fund?**

26

27 A. Section 254(b) of TA96 states as follows:

1 UNIVERSAL SERVICE PRINCIPLES. – The Joint Board and the
2 Commission shall base policies for the preservation and
3 advancement of universal service on the following principles:

4 ...

5 (4) Equitable and Nondiscriminatory Contributions. – All
6 providers of telecommunications services should make an
7 equitable and nondiscriminatory contribution to the
8 preservation and advancement of universal service.

9 ...

10 (7) Additional Principles. – such other principles as the Joint
11 Board and the Commission determine are necessary and
12 appropriate for the protection of the public interest,
13 convenience, and are consistent with this Act.
14

15 Furthermore, Section 254(b)(f) restricts State Authority as follows:

16 A State may adopt regulations not inconsistent with the
17 Commission's rules to preserve and advance universal service.
18 Every telecommunications carrier that provides intrastate
19 telecommunications services shall contribute, on an equitable and
20 nondiscriminatory basis, in a manner determined by the State to
21 the preservation and advancement of universal service in that State.
22 A State may adopt regulations to provide for additional definitions
23 and standards to preserve and at such definitions or standards that
24 do not rely on or burden Federal universal service support
25 mechanisms.
26

27 **Q. How has the FCC interpreted the requirement contained in Section 254(b)(4)**
28 **of TA96?**

29
30 A. This principle has been interpreted by the FCC as follows:

31 Universal service support mechanisms and rules should be
32 competitively neutral. In this context, competitive neutrality means
33 that universal service support mechanisms and rules neither unfairly
34 advantage nor disadvantage one provider over another, and neither
35 unfairly favor nor disfavor one technology over another.
36

37 CC Docket No. 96-45, Report and Order rel. May 8, 1997, ¶47. The FCC adopted
38 the Joint Board's recommendation to assess contributions on retail revenues.

39 Specifically, the FCC stated:

We agree with the Joint Board's recommendation that we must assess contributions in a manner that eliminates the double payment problem, is competitively neutral and is easy to administer. To address the Joint Board's concerns, we find that contributions should be based on end-user telecommunications revenues.

Id., ¶843. The FCC further rejected "commenters' suggestions that contributions be calculated entirely on non-revenue-based measures, such as a per-minute of use or per-line basis at this time." (Id., ¶852)

Q. How have the current Illinois Fund obligations been assessed in the past?

A. The current IHCF is currently assessed on Illinois intrastate toll providers. Because it is an expense incurred in connection with a provider's toll usage, it is treated as an incremental cost of toll, and eventually recovered from toll customers. Similarly, the DEM Weighting Fund is assessed on the major intrastate toll providers at a level proportionate to the assessment of intrastate access charges billed to these IXC's by the rural companies in total. These mechanisms require that only toll customers fund the maintenance of universal service in Illinois.

Q. Would continuing this method of assessment for the interim state universal service fund satisfy the criteria of TA96 and the Illinois statute?

A. No. In addition to the inequity to end users discussed above, assessment based upon toll usage is not competitively neutral because it advantages a provider that provides little or no intrastate toll service, such as the ILECs included in the stipulated agreement. As discussed above, the FCC specifically rejected such an

1 approach, despite the fact that previous subsidies were collected from toll
2 providers on a per minute-of-use basis. Furthermore, the Illinois statute requires
3 any Section 13-301(d) state universal service funds be recovered from all
4 interexchange carriers and local exchange carriers certificated by the
5 Commission. By expressly including “local exchange carriers” as funding
6 carriers, the legislature clearly expressed its intent that funding be assessed on
7 more than just toll carriers.

8

9 **Q. Does the Illinois Public Utilities Act contain other requirements for funding**
10 **a state universal service fund?**

11
12 A. Yes. In addition to the requirement I discussed above, Section 13-301(d) of the
13 Illinois statute requires that the Commission not permit universal service support
14 cost recovery from another certificated carrier for any service purchased and used
15 solely as an input to a service provided to such certificated carrier's retail
16 customers. As a primary example, this means that a carrier may not recover its
17 funding obligations via access service or other wholesale services.

18

19 **Q. What recommendation do you make to the Commission that would comply**
20 **with this Section 13-301(d) requirement?**

21
22 A. Each provider should be allowed to recover its obligations by passing them on to
23 its end users, similar to the way any other cost of doing business is passed on to
24 end users. However, the Commission should ensure that any method
25 implemented by a provider does not have an anti-competitive impact. AT&T
26 believes that it would be appropriate for the Commission to structure a charge

1 either as a uniform flat monthly charge assessed by each local exchange carrier
2 for each access line, or as a charge every intrastate telecommunications services
3 provider assesses to its retail customers as either a flat charge or as a uniform
4 percentage of current intrastate end user revenues, at the option of the carrier.

5

6 **Q. In its Order To Clarify, issued December 18, 2000 in these proceedings, the**
7 **Commission requested parties to discuss what impact Section 13-301(a) of**
8 **the PUA has on the Commission's authority to establish a state universal**
9 **service fund. Can you please comment on this?**

10

11 A. Although I am not an attorney, the language contained in Section 13-301(d)
12 appears to provide whatever clarification is needed on this issue. Section 13-
13 301(a) provides for the Commission to establish a Universal Telephone Service
14 Assistance Program for low income residential customers. Section 13-301(d)
15 provides for the Commission "to investigate the necessity of and, if appropriate,
16 establish a universal service support fund from which local exchange
17 telecommunications carriers ... whose economic costs of providing services for
18 which universal service support may be made available exceed the affordable
19 rate" Nowhere is there an indication that one type of support (e.g., low
20 income support) is mutually exclusive of another type of support (e.g., high cost
21 support). Thus, while legal counsel will address this issue more thoroughly in
22 briefs, it appears that Section 13-301(a) has no impact on the Commission's
23 authority to establish a universal service fund pursuant to Section 13-301(d).

24

25 **Q. Are there any other issues you recommend the Commission address in these**
26 **proceedings?**

27

1 A. Yes. An issue of primary concern is that Section 13-301(d) appears to limit the
2 distribution of funds to certain incumbent local exchange carriers. In order for a
3 universal service fund to be considered truly competitively neutral, the funds must
4 be portable to providers or, alternatively, distributed directly to end users
5 regardless of which LEC provides local service to those end users. However,
6 given the time constraints facing the parties in these proceedings, along with a
7 realization of limited (or no) competition in the exchanges involved, a consensus
8 was reached during a March 9, 2000 Staff-chaired workshop that this issue should
9 be deferred to a later phase in these consolidated dockets or to a newly initiated
10 docket that would address a state universal service fund provided for in Section
11 13-301(e) of the statute. *See* Comments of the Staff filed March 14, 2001 in these
12 consolidated dockets, p. 1. A fund established pursuant to Section 13-301(e) does
13 not restrict distributions to certain incumbent local exchange carriers to the
14 exclusion of other carriers.

15
16 **Q. When do you recommend the Commission initiate such a docket?**

17 A. I recommend that once the evidentiary hearing for these instant proceedings has
18 concluded, a workshop be convened to discuss the potential scope of the next
19 investigative phase of universal service issues. For purposes of encouraging
20 competition and, therefore, consistent with the public interest, I recommend that
21 there be a mandatory transition from receiving funds from a Section 13-301(d)
22 fund to receiving funds from a Section 13-301(e) fund. The “trigger” for such a

1 transition should be determined now, so that any potential competition in these
2 exchanges is not discouraged.

3

4 **Q. Does this conclude your testimony?**

5 **A.** Yes, it does.